Supreme Court, U.S.
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No. 97-1701

IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

NATIONSMART CORPORATION, *et al.*,
Petitioners,

v.

JACK CARLON, HELEN S. PALMQUIST,
BRIAN PALMQUIST, and JOHN D. PALMQUIST,
Respondents.

On Petition for a Writ of Certiorari to the
United States Court of Appeals for the Eighth Circuit

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

Respondents do not agree that the issues stated by Petitioners are properly presented for review. The three "Questions Presented For Review" set out in the Petition for Writ of Certiorari do not accurately characterize the issues decided by the United States Court of Appeals for the Eighth Circuit, nor arise by necessary implication from that Court's decision. The actual "Statement of Issues Presented for Review" in the Court of Appeals was set out by the Brief of Appellants (now Respondents) filed in that Court, and is reproduced here in Respondents' Appendix G.

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RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

STATUTES AND REGULATIONS INVOLVED

The Petition for Writ of Certiorari cites Federal Rule of Civil Procedure 9(b) as the only statute or regulation involved in this case, although in their Appendix F Petitioners also set out in full, under the heading "Relevant Statutes and Regulations", the former Sections 11 and 12(2) of the Securities Act of 1933, 15 U.S.C. §77k and §77*l*(2) (1994)[1], and Securities and Exchange Commission Rule 175, 17 C.F.R. §230.175. The Petition refers to several other statutory provisions and regulations, including Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), but does not list them as "involved" in the case nor quote them in the Appendix.

Respondents state that the following rules are involved in the case, in addition to former Sections 11 and 12(2) of the Securities Act of 1933, 15 U.S.C. §77k and §77*l*(2) (1994), and Federal Rule of Civil Procedure 9(b):

Federal Rules of Civil Procedure, Rule 8(a) and (e):

> **(a) Claims for Relief.** A pleading which sets forth a claim for relief, whether an original claim, counterclaim, cross-claim, or third-party claim, shall contain (1) a short and plain statement of the grounds upon which the court's

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[1] Those statutes, which were in force at the time this case was commenced, have since been substantially amended by the Private Securities Litigation Reform Act of 1995, P.L. 104-67, 109 Stat. 757 (1995), Title II, §201(b) and Title I, §105 respectively. The amendment to Section 12(2), 15 U.S.C. §77*l*(2), P.L. 104-67, Title I, §105, renumbered it as Section 12(a)(2), 15 U.S.C. §77*l*(a)(2).

jurisdiction depends, unless the court already has jurisdiction and the claim needs no new grounds of jurisdiction to support it, (2) a short and plain statement of the claim showing that the pleader is entitled to relief, and (3) a demand for judgment for the relief the pleader seeks. Relief in the alternative or of several different types may be demanded.

(e) Pleading to be Concise and Direct; Consistency.

(1) Each averment of a pleading shall be simple, concise, and direct. No technical forms of pleading or motions are required.

(2) A party may set forth two or more statements of a claim or defense alternately or hypothetically, either in one count or defense or in separate counts or defenses. When two or more statements are made in the alternative and one of them if made independently would be sufficient, the pleading is not made insufficient by the insufficiency of one or more of the alternative statements. A party may also state as many separate claims or defenses as the party has regardless of consistency and whether based on legal, equitable, or maritime grounds. All statements shall be made subject to the obligations set forth in Rule 11.

STATEMENT OF THE CASE

Respondents consider that the Petition for Writ of Certiorari significantly misstates both the facts and the law bearing on the issues which would properly be before the Court if certiorari were granted. Accordingly, although Respondents would not otherwise be required to file a brief in opposition to the Petition under this Court's Rule 15.1, Respondents have an obligation to address such misstatements in this brief, pursuant to Rule 15.2.

The principal issue actually decided by the Court of Appeals was the sufficiency of Respondents' Consolidated Amended Class Action Complaint. The appendix supplied by Petitioners does not include that complaint. Respondents set it out in full herewith, as Appendix H.

A. The Nature of the Case

This consolidated class action arose out of the initial public offering of 2,000,000 units of the securities of NationsMart Corporation on December 22, 1993, at a price of $7.00 per unit ("Offering"). NationsMart, begun in 1992, failed soon after the Offering. By July 1994—following a "whistleblower" lawsuit by Petitioner Alice Brueggemann, its former Chief Financial Officer, which alleged improprieties, misrepresentations and omissions in the Offering's registration statement and prospectus—NationsMart's stock price fell to $1.875 per share. By May 1995 the stock became virtually worthless and was delisted from trading. (A 2-4, H 1, 3-4, 21-22.)

Respondents, as purchasers of securities in the Offering, sought damages against NationsMart, its officers, directors, and lead underwriters under former Sections 11 and 12(2) of the Securities Act of 1933, with a third count under Section 10(b) of

the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5.[2] (A 2, 4, H 1-31.)

Contrary to Petitioners' statement at page 4 of their Petition for Writ of Certiorari, and as the Court of Appeals recognized, Respondents did *not* allege "a single fraudulent scheme as the purported basis of liability" under all three statutes.[3] (A 7.)

B. The Course of Proceedings and Disposition Below

The four plaintiffs (Respondents here) filed suit in November 1994, and after the consolidation of their lawsuits in the District

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[2] The class representative plaintiffs (here Respondents) each purchased 1000 NationsMart units issued pursuant to the Offering. The individual defendants (Petitioners) who signed and drafted the allegedly false and misleading Offering Materials were Michael E. Thaman, NationsMart's President, Chief Executive Officer and one of its directors; Alice E. Brueggemann, its Senior Vice President, Treasurer and Chief Financial Officer until her termination on March 8, 1994 for calling attention to the other defendants' misconduct; S. Leslie Flegel, a founder of the company, director and Chairman of its Executive Committee; Mel A. Friedman (now deceased), another founder, director and Executive Vice President; Alan G. Johnson, a director and Secretary; Franklin Jacobs, a director and member of the Executive Committee; S. Lee Kling, a director, member of the Executive Committee and Chairman of the Board until June 1993; and Michael J. Dunlap, the Controller and Principal Accounting Officer. Respondents RAS Securities Corporation and PCIA, Inc. (then Pauli & Company, Inc.) were the lead underwriters of the Initial Public Offering and shared underwriting discounts and fees in excess of $2,000,000 from it. (A 2-4, H 3-7, 9.)

[3] The Consolidated Amended Class Action Complaint which was the subject of the rulings below first stated its factual allegations as to the circumstances of the case generally, without specifying legal theories of recovery or asserting that Petitioners committed fraud. (H 1-25.) Its three Counts then incorporated those facts and added further allegations to bring them within the scope of each Count's legal theory. (H 25-31.) Only Count III characterized Respondents' acts as a scheme to defraud under §10(b) and Rule 10b-5. (H 27-30.) It is Petitioners, not Respondents, who have chosen to characterize the facts alleged in the complaint as claims of fraud in the two Counts based on §11 and §12(2).

Court they were permitted to file a consolidated complaint on May 1, 1995. (A 4, H 1-31.) The District Court certified two plaintiff classes in November 1995 (A 4), but on April 11, 1996, it granted Petitioners' motions to dismiss the complaint under Federal Rules of Civil Procedure 12(b)(6) and 9(b), with prejudice, except as to certain post-offering claims against the underwriters under former §12(2) which it also later dismissed. The District Court applied Rule 9(b) to all three counts of the complaint, including those not alleging fraud. It ruled that each of the three counts had failed to plead fraud with sufficient particularity to state a claim upon which relief could be granted. (A 5-6.)

On November 21, 1997, the Court of Appeals reversed the judgment of the District Court in part and reinstated Counts I and II of the complaint against all the Petitioners (there Appellees), remanding the case for further proceedings not inconsistent with its opinion. (A 24.) The Court of Appeals held those Counts had adequately pleaded claims for relief under former §11 and §12(2), while affirming the dismissal of Count III, Respondents' fraud claim under §10(b). (A 9, 14, 17.) With one judge dissenting,[4] the Court of Appeals denied these Petitioners' petition for rehearing and suggestions for rehearing en banc on January 15, 1998. (E 1.)

C. Facts Material to Consideration of the Questions Presented

NationsMart was formed in 1992 to provide dry cleaning, laundry and shoe repair services at leased locations in Wal-Mart and Kmart stores. (A 2, H 3-4, 9) Its Prospectus and Registration Statement (the "Offering Materials") represented this concept as a viable one which could, with the aid of the proceeds of the

[4] The Honorable C. Arlen Beam, Circuit Judge, who had also dissented from the panel opinion written by Chief Judge Richard S. Arnold and concurred in by Senior Circuit Judge Floyd R. Gibson.

Offering, expand to 600 stores by 1998. The Offering Materials portrayed NationsMart as a rapidly growing company which, with a capital infusion from the Offering, was poised to reap enormous profits. (H 4, 9-11, 13.)

Respondents alleged, however, that those Offering Materials misstated historical facts concerning NationsMart's finances and operations, including the material adverse financial trends which were being experienced by NationsMart in the months leading up to the Offering, along with the nature and indeed the existence of its employee training programs, merchandising techniques, standardized store opening procedures, point-of-sale and management information systems; and further misrepresented the uses to which the proceeds of the Offering would be put. (A 5, 11, H 13-17.)

In addition, Respondents alleged, the Offering Materials contained projections of future financial performance, based upon a purported "financial model". (A 3, H 9-12.) The Prospectus also contained a section called "Risk Factors" and other cautionary statements to the effect that the NationsMart "financial model" reflected "only the best judgment of management" and was subject to conditions beyond the company's control. (A 3, H 12.) However, the statement at page 2 of the Petition for Writ of Certiorari that the "predictions and warnings contained in the Prospectus are undisputed" is by no means correct. (A 10, 13-14, H 2-3, 10-17, 21.)

Respondents alleged in their complaint that the Prospectus's projections incorrectly stated that NationsMart's revenues, profits and cash flows had been trending and would continue to trend in a positive direction. (A 5, H 10-12, 14-16.) The business plan set forth in the Prospectus was not supported but contradicted by internal sales, margin, expense and overhead data prepared and

circulated within the company and to the Underwriters in the months prior to the Offering. (A 11, H 13-14, 16-17.)

The Prospectus stated that the proceeds of the Offering would fund the planned opening of 108 new stores by October 1994. (A 3, H 9.) The Offering Materials were thus designed to and did convey the message that the company's expectations for growth were based upon a meaningful "financial model" which NationsMart had developed from its experience to date, and in which Petitioners held a justifiable, good faith belief. (H 11-13, 15.) They failed to disclose, however, that if present and historical revenue, profit and expense trends continued, the company would be out of capital by mid-1994 and unable to fund its existing stores (which were not trending toward profitability), let alone finance the opening of 108 new stores. (A 5, H 13, 16-17.) Respondents alleged that as of the date of the Offering, NationsMart's performance was well below the "model", showed little prospect of catching up with the model, and was deteriorating and falling further and further behind the model. In the months immediately prior to the Offering, many indicators of its performance and future success were on a downward slope. (H 16-17.)

Respondents further alleged the Prospectus's "Risk Factors" section was misleading. (A 13, 15.) It disclosed, in a general fashion, categories of risk inherent in a new business with a program of aggressive expansion like that supposedly planned by NationsMart, but omitted to disclose actual risks and adverse conditions then affecting the company. It also contained statements which minimized the risks it did disclose, such as the "going concern" risk which the company's accountants had noted. (A 12-14, H 11-12, 15.)

Evidence of the company's true financial condition and its prior misstatements to the investing public emerged on June 27, 1994, when Brueggemann filed suit against NationsMart and its directors over her secretive dismissal in March 1994. (H 21-22.) In that lawsuit—which was quickly settled subject to stringent non-disclosure agreements—Brueggemann alleged she had been fired for telling Thaman, Kling, Johnson and Jacobs in January 1994, just days after the Registration Statement became effective, that among other things:

> —sales forecasts set forth in the Prospectus were falsely optimistic, and she had insisted that the S-1 registration should be revised to reflect known negative facts and adverse developments;
>
> —Thaman had been "burying" loans to friends in false financial statements; and
>
> —certain affiliated party dealings were, contrary to the Prospectus, not at arms' length and unfair to NationsMart.[5]

All those facts, Respondents alleged, were omitted from the Offering Materials. (H 2, 21.)

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[5] All the individual defendants except Brueggemann and Dunlap owned hundreds of thousands of shares of NationsMart stock at the time of the Offering. Furthermore, Thaman, Flegel, Friedman, Johnson, Jacobs and Kling were also purportedly owed thousands of dollars by NationsMart, which were repaid from the proceeds of the Offering. Flegel and Friedman sold tens of thousands of shares of NationsMart stock during the Class Period. Johnson is also a senior partner in the law firm of Gallop, Johnson & Neuman, L.C., and was the Secretary of Petitioner PCIA, Inc. (then Pauli & Company, Inc.). His law firm derived substantial income from legal services allegedly provided to NationsMart during the Class Period and, as a partner of the law firm, Johnson shared in those revenues. Businesses controlled by Flegel and Jacobs also sold goods and services to NationsMart. (H 4-6, 9-10.)

REASONS FOR DENYING THE WRIT

There is no compelling reason to review the well-reasoned decision of the Court of Appeals. It decided no constitutional question, no important public controversy, and no significant issue of statutory interpretation, but merely remanded two civil, non-fraud claims at the pleading stage to the District Court for further proceedings.

The provisions of the Securities Act applicable to this case have been amended and will not control any future disputes. Petitioners have even overstated the decision's reach in the application of Federal Rule of Civil Procedure 9(b) to particular circumstances in securities cases not requiring the pleading or proof of fraud. There has been no departure from "the accepted and usual course of judicial proceedings", in the words of Rule 10(a), Rules of the Supreme Court of the United States, to call for an exercise of this Court's supervisory power.

The majority and the dissent in the Court of Appeals agreed on the applicable, well-established law and on the facts of the case, disagreeing only on the application of the law to the allegations of Respondents' complaint. As this Court's Rule 10 provides, "A petition for a writ of certiorari is rarely granted when the asserted error consists of erroneous factual findings or the misapplication of a properly stated rule of law."

I. There Is No Need for This Court to Interpret Federal Rule of Civil Procedure 9(b) to Resolve the Fact-Bound Dispute About Its Application in This Case.

Based on the actual allegations of the complaint, and not on the characterizations of that complaint by Petitioners or the District Court, the Court of Appeals unanimously held that: (1) Respondents did not seek to plead fraud, and did not plead fraud, in their §11 and §12(2) claims; (2) claims under those statutes do not require fraud nor sound in fraud; and (3) even if the attempted §10(b) fraud claims of the complaint's Count III were deemed to

have spilled over accidentally into Counts I and II, the appropriate remedy would be to disregard such allegations as surplusage, not to jettison the complaint altogether.[6]

Based on the actual text of the Court of Appeals's opinion, it is a misrepresentation for the Petition for Writ of Certiorari to claim broadly (as it does at page 5) that the decision held "a plaintiff's one-sentence disclaimer is sufficient to nullify factual averments of fraud for purposes of Rule 9(b)", and "'fraud' for purposes of Rule 9(b) does not include forward-looking statements made without any reasonable basis." The opinion neither says nor means any such thing. What it does hold (A 6-8, 15) is that the *application* of Rule 9(b) to the §11 and §12(2) claims pleaded in Counts I and II of Respondents' complaint would be contrary to the strong remedial policies of those statutes, contrary to Rule 8(e)(2), and contrary to the binding precedents of this Court. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381-383, 103 S.Ct. 683, 74 L.Ed.2d 548 (1983); *Conley v. Gibson*, 355 U.S. 41, 47, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957); *Leatherman v. Tarrant County Narcotics and Intelligence Coordination Unit*, 507 U.S. 163, 168, 113 S.Ct. 1160, 122 L.Ed.2d 517 (1993).

The first "Question Presented for Review" in the Petition for Writ of Certiorari—"Whether the phrase 'averments of fraud' in Rule 9(b) of the Federal Rules of Civil Procedure encompasses averments of fraud where scienter is not a required element of a plaintiff's cause of action"—is thus a red herring, because there simply were no averments of fraud in Respondents' Counts I and II. Even if any such averments had been present, they could not

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[6] The Court of Appeals's opinion was unanimous regarding the inapplicability of Rule 9(b) and the sufficiency of the complaint's pleaded allegations of those claims under Rule 8. Judge Beam dissented only as to the substantive validity of Respondents' §11 and §12(2) causes of action under the "Bespeaks Caution" doctrine.

have determined the outcome of the case, because, as the Court of Appeals held, the complaint set out "more than was necessary to recover" under §11 and §12(2) without them. (A 7, 15.) Moreover, Petitioners' question is much too broadly stated to review here, because, unlike the decision below, it is not limited to §11 and §12(2) cases.

The second "Question Presented for Review"—"Whether the phrase 'averments of fraud' in Rule 9(b) of the Federal Rules of Civil Procedure encompasses averments that representations were made without a reasonable basis"—is both too broad and too narrow. Like the first question, its scope is broader than the decision in this Securities Act case warrants. It is also too narrow, however, because the complaint alleged material omissions as well as representations without a reasonable basis, and the Court of Appeals found the §11 and §12(2) claims sufficient on the basis of the omissions as well as the misrepresentations. (A 11, 13-15.)

Petitioners' argument is founded on a hair-splitting attempt to construe the term "averments of fraud" in Rule 9(b) as something different from "claims" requiring proof of fraud, and then to attribute to the Eighth Circuit a failure to understand that nonexistent distinction.[7] Petitioners would have it that "averments of fraud" are any pleaded factual allegations which an adversary or a judge might choose to interpret as the virtual equivalent of fraud. Rather, the term "averments" implies specific intention on the part of the pleader. *Black's Law Dictionary*, Revised Fourth Edition (1968), at 172, defines "averment" as "In pleading. A positive statement of facts, in opposition to argument or inference."

Petitioners rely on a supposed distinction between the words "averments" and "claims" in Federal Rules of Civil Procedure

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[7] *See* Petition for Writ of Certiorari, page 8; *compare* the opinion of the Court of Appeals at A 7-8.

8(a) and 10(b). In fact, Rule 8(a) does not use the term "averments" at all, and Rule 10(b) includes it only in the phrase "averments of claim". The real distinction is between "averments of fraud" and "circumstances constituting fraud" in the text of Rule 9(b) itself: "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be alleged generally."

The lower Federal courts have routinely and successfully applied this rule for decades. They should continue to do so without requiring this Court's intervention in the present case.

A. There Is No Meaningful Split Among the Circuits Regarding the Applicability of Rule 9(b) in Securities Act Cases Where Scienter Is Not Required and Not Alleged.

What Petitioners call a direct conflict with decisions of the First, Third, Fifth and Ninth Circuits is better described as a series of results turning, as they should, on the specific facts pleaded in each different case. It has been widely held, for more than twenty years, that Securities Act claims are not subject to Rule 9(b)'s specificity requirements, unless such claims actually rely on allegations of fraud—unlike Respondents' Counts I and II, which do not allege and, indeed, expressly disavow fraud.[8] Not until the present decade did any court find a §11 or §12(2) case subject to dismissal for depending on actual allegations of

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[8] *Schwartz v. Celestial Seasonings, Inc.*, 124 F.3d 1246, 1252 (10th Cir. 1997); *Shaw v. Digital Equipment Corp.*, 82 F.3d 1194, 1223 (1st Cir. 1996); *Shapiro v. UJB Financial Corp.*, 964 F.2d 272 (3d Cir. 1992); *Schoenfeld v. Giant Stores Corp.*, 62 F.R.D. 348 (S.D.N.Y. 1974); *Billet v. Storage Technology Corp.*, 72 F.R.D. 583 (S.D.N.Y. 1976); *Roskos v. Shearson/American Express, Inc.*, 589 F.Supp. 627 (E.D.Wisc. 1984); *In re Consumers Power Co. Securities Litigation*, 105 F.R.D. 583, 594-95 (E.D.Mich. 1985); *In re Lilco Securities Litigation*, 625 F.Supp. 1500 (E.D.N.Y. 1986); *Bernstein v. Crazy Eddie, Inc.*, 702 F.Supp. 962, 973 (E.D.N.Y. 1988).

fraud which were pleaded without particularity. The various Circuits of the Court of Appeals do not disagree on the governing principles but at most have varied their application from case to case, consistently with their role in the Federal appellate system.[9]

Petitioners suggest there is also a split among the Circuits in regard to the effect of pleaded disclaimers of fraud. They exaggerate. The disclaimer here was only one among several equally valid reasons for finding Respondents' §11 and §12(2) allegations sufficient as against Rule 9(b). The language from the Ninth Circuit case which Petitioners say is in conflict with the Eighth Circuit's ruling on this point, *In re Stac Electronics Securities Litigation*, 89 F.3d 1399 (9th Cir. 1996), was actually *dictum*, since the trial court dismissed the §11 claims involved there under Rule 12(b)(6) rather than Rule 9(b).

The Courts of Appeals have not required micro-management of their decisions on such narrow issues of pleading in the past. There is no reason to consider that they suddenly require it now.

B. The Court of Appeals's Opinion Merely Applied Established Pleading Principles to Averments Sufficient under Sections 11 and 12(2) of the Securities Act of 1933, Which Neither Needed Nor Attempted to Allege Fraud.

The overriding message of *Conley v. Gibson*, 355 U.S. 41, 48, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957), bears repetition: "The Federal

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[9] As this Court has long recognized, "it is very important that we be consistent in not granting the writ of certiorari except in cases involving principles the settlement of which is of importance to the public, as distinguished from that of the parties, and in cases where there is a real and embarrassing conflict of opinion and authority between the Circuit Courts of Appeals." *Layne & Bowler Corporation v. Western Well Works, Inc.*, 261 U.S. 387, 393, 43 S.Ct. 422, 67 L.Ed. 712 (1923); *Rice v. Sioux City Memorial Park Cemetery*, 349 U.S. 70, 79, 75 S.Ct. 614, 99 L.Ed. 897 (1955).

Rules reject the approach that pleading is a game of skill in which one misstep by counsel may be decisive to the outcome and accept the principle that the purpose of pleading is to facilitate a proper decision on the merits."

The Court of Appeals's ruling upheld this principle, and the statutory policy of §§11 and 12(2) enunciated by the Supreme Court, as well. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 379-382, 103 S.Ct. 683, 74 L.Ed.2d 548 (1983), declared that conduct giving rise to an implied cause of action under §10(b) of the Securities Exchange Act of 1934 may also, in cumulative fashion, be "subject to an express civil remedy" under the Securities Act of 1933. This Court held that a party should not be barred from invoking a remedy for fraud merely because the same conduct "would apparently also provide the basis for a damages action under §11 of the 1933 Act." It stated:

> "... the two provisions involve distinct causes of action and were intended to address different types of wrongdoing.
>
> Section 11 of the 1933 Act allows purchasers of a registered security to sue certain enumerated parties in a registered offering when false or misleading information is included in a registration statement. The section was designed to assure compliance with the disclosure provisions of the Act by imposing a stringent standard of liability on the parties who play a direct role in a registered offering.
>
> ... Although limited in scope, §11 places a relatively minimal burden on a plaintiff. In contrast, §10(b) is a 'catchall' antifraud provision, but it requires a plaintiff to carry a heavier burden to establish a cause of action. ... Most significantly, he must prove that the defendant acted with scienter, i. e., with intent to deceive, manipulate, or defraud."

Petitioners' effort to apply Rule 9(b) to claims under the 1933 Act, whenever the underlying conduct happens to coincide with

conduct also actionable under §10(b) of the 1934 Act, would stand *Herman & MacLean* on its head. The position for which they argue would impede the clearly available, *express* statutory remedies under §§11 and 12(2), which do not require averments or proof of scienter, if any facts exist for which there might be an *implied* remedy with a higher burden of pleading and proof. It would create the paradox that, the more egregious the conduct complained of, the harder it would become to obtain relief under §11 or §12(2), which are supposed to require a very low pleading and proof threshhold. *See, e.g.*, L. Loss & J. Seligman, *Fundamentals of Securities Regulation*, Third Edition (1995), at 1002. The application of Rule 9(b) to cases such as this would only encourage plaintiffs falsely to "underplead" their claims (giving defendants less notice and specificity rather than more), and discourage use of the cumulative remedy of §10(b), contrary to the statutes and *Herman & MacLean*.

The requirement of Rule 9(b) that averments of fraud be pleaded with particularity has several purposes—adequate notice of the nature of serious allegations; protection of defendants' reputations from imaginary charges of wrongdoing; discouraging meritless "strike suits" and "fishing expeditions"—but none of them was violated by the allegations of Respondents' complaint. Petitioners had adequate notice of claims which did not improperly besmirch their reputations. Everything alleged about Petitioners came straight from their own statements and documents. It was no more scandalous or secret than the conduct for which NationsMart's Chief Financial Officer Brueggemann had already sued and settled with the company and its principals.

The wide-ranging application of Rule 9(b) which Petitioners seek disregards Rule 8(e)(2), which specifically allows alternative pleading and would entitle Respondents to plead that Petitioners' conduct was willful, or, alternatively, negligent, or even innocent. Rule 8(e)(2) also specifically states that when two or more statements of a claim "are made in the alternative and one of them if made independently would be sufficient, the pleading

is not made insufficient" by any insufficiency of another of the alternative statements of claim.

Rule 9(b) and Rule 8(e)(2) must be construed together, to give effect to each. As the Court of Appeals recognized (A 7), §11 provides liability even for innocent misstatements. While Petitioners have assailed the disavowal of fraud in Appellants' §11 and §12(2) claims, in fact the complaint did only what Rule 8 expressly permits. *See* C. Wright & A. Miller, *Federal Practice and Procedure*, Civil 2d, Volume 5 (1990), §1257 and §1282; *Babcock & Wilcox Company v. Parsons Corporation*, 430 F.2d 531 (8th Cir. 1970); *In re Sunrise Securities Litigation*, 793 F.Supp. 1306 (E.D.Pa. 1992).

The Petition for Writ of Certiorari contradicts itself. On one hand, it asserts at pages 8 and 9 that Respondents' complaint was so "generalized" it failed to state a claim of any sort. On the other, Petitioners insist the complaint was so definite that it alleged fraud, and *only* fraud. The reality, of course, is that the complaint is full of references to statements and omissions whose motivation, if any, is unknown and undescribed. But on a motion to dismiss, where all inferences are to be drawn in the pleaders' favor, the courts below were required to give Respondents benefit of the doubt as to the degree they were alleging scienter. The Court of Appeals committed no error in doing so.

II. The Court of Appeals's Routine Application of the "Bespeaks Caution" Doctrine to the Specific Facts of This Case Raises No Conflict with Its Own or Any Other Circuit's Established Precedent.

The Petition for Writ of Certiorari states its last "Question Presented for Review" as "Whether risk disclosures that are tailored to a company's projections must predict the precise timing of future business reverses in order to render the projections immaterial under the federal securities laws." That is an imaginary issue, unsupported by the record. At page 5, the

Petition mischaracterizes the Court of Appeals's decision as a finding that the warnings in NationsMart's Prospectus "did not render the projections immaterial under the bespeaks caution doctrine because the Company had not predicted *precisely when* it would run out of money. (A 13.)" The cited passage of the opinion, however, does not say what Petitioners contend it says. It does not even come close.

Such misstatements by Petitioners are sufficient reason alone to deny certiorari. But the underlying legal premise of Petitioners' argument is also untrue. The Court of Appeals did not depart from established precedent under the Bespeaks Caution doctrine. It simply applied, in effect, the same "total mix" principle set out in *TSC Industries, Inc. v. Northway*, 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976), in a manner entirely consistent with its own and other Circuits' prior decisions.

For the Bespeaks Caution doctrine to apply, cautionary language in a prospectus must be precise and must directly address the risks attending projections, estimates or forecasts. *In re Donald J. Trump Casino Securities Litigation*, 793 F.Supp. 543, 554 (D.N.J. 1992), *affirmed* 7 F.3d 357 (3d Cir. 1993); *Moorhead v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 949 F.2d 243, 245-246 (8th Cir. 1991); *Polin v. Conductron Corp.*, 552 F.2d 797 (8th Cir. 1977); *I. Meyer Pincus & Associates, P.C. v. Oppenheimer & Co.*, 936 F.2d 759 (2d Cir. 1991); *Goldman v. Belden*, 754 F.2d 1059 (2d Cir. 1985). The statements must *directly relate* to the risks. *Hanon v. Dataproducts Corp.*, 976 F.2d 497, 504 (9th Cir. 1992) ("more than generalized statements of risk" are necessary to alert the market to problems faced by an issuer of securities); *Pommer v. Medtest Corporation*, 961 F.2d 620, 624-25 (7th Cir. 1992) ("boilerplate" or "generic" warnings about the normal risks of doing business "do nothing to disabuse an investor" influenced by false statements). *In re Worlds of Wonder Securities Litigation*, 35 F.3d 1407, 1414-1415 (9th Cir. 1994), approved a district court's holding that "blanket warnings that securities involve a high degree of risk

[are] insufficient to ward against a federal securities fraud claim." The "warnings" here, however, were neither specific nor adequate. (A 14).

The Bespeaks Caution doctrine is a judge-made rule which had its origin in the Eighth Circuit's own decision in *Polin*, *supra*. Since then, it has routinely been applied with diverse results in a great variety of factual situations, including *Parnes v. Gateway 2000, Inc.*, 122 F.3d 539 (8th Cir. 1997), decided just weeks before the decision below. The Court of Appeals's interpretation and application of its own doctrine in the present case, citing *Polin* and *Moorhead*, *supra*, should therefore be entitled to considerable deference, consistently with the principle of this Court's Rule 10 that certiorari is rarely appropriate where the only asserted error is "the misapplication of a properly stated rule of law."

At any rate, misrepresentations and omissions of current and historical fact are not immunized from liability by the Bespeaks Caution doctrine, regardless of any warning language.[10] *Griffin v. McNiff*, 744 F.Supp. 1237, 1253-54 (S.D.N.Y. 1990), *affirmed* 996 F.2d 303 (2d Cir. 1993); *Shaw v. Digital Equipment Corp.*, *supra*, 82 F.3d 1194, 1213 (1st Cir. 1996). The Court of Appeals recognized this principle and correctly applied it here. It found,

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[10] Reduced to its essence, Petitioners' argument is that because they repeatedly told investors that NationsMart's Offering was a risky deal which might fail, it does not much matter what else was in the Offering Materials. They are claiming that if issuers disclose the bare *fact* of risk, they have no obligation to disclose the details of its nature, extent or likelihood, nor to tell the truth about anything else material to the Offering. But if that argument were true, issuers could always avail themselves of blanket immunity for any and all misstatements and omissions, simply by including magic warning language in every prospectus. Such an expedient would wholly undermine the securities laws' fundamental purpose of providing the market with complete and accurate information about investments.

correctly, that Respondents had alleged misstatements and omissions of present fact sufficient to withstand dismissal. (A 13-16.)

Under all these well-established precedents, the evaluation of whether warnings in a given case do or do not provide a "total mix" of information adequate to bespeak caution to reasonable investors is precisely the type of fact-specific inquiry which is within the competence of the Court of Appeals, and from which certiorari should not lie. The result in this case was correct and there is no reason for this Court to disturb it.

CONCLUSION

For the foregoing reasons, Respondents state that the Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit should be denied.

Respectfully submitted,

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APPENDIX

APPENDIX G

STATEMENT OF ISSUES PRESENTED FOR REVIEW IN THE COURT OF APPEALS, FROM THE BRIEF OF APPELLANTS

STATEMENT OF ISSUES PRESENTED FOR REVIEW

1. Whether the District Court erred in dismissing Counts I and II of Appellants' Consolidated Amended Class Action Complaint for failure to state claims upon which relief can be granted under Sections 11 and 12(2) of the Securities Act of 1933.

(a) Whether the District Court erred in applying Federal Rule of Civil Procedure 9(b) to Counts I and II of the complaint and finding that Appellants had failed to plead allegations of fraud with particularity, in that neither fraud nor scienter is an element of claims under Sections 11 and 12(2) and the complaint had specifically disclaimed fraud as a ground for Appellants' Section 11 and Section 12(2) claims.

(b) Whether the "Bespeaks Caution" and "Safe Harbor" doctrines constitute an absolute bar to any and all claims Appellants alleged under Sections 11 and 12(2), regardless of any misrepresentations or omissions of historical fact in the Offering Materials which are the subject of the case.

(c) Whether Counts I and II of the Consolidated Amended Class Action Complaint contained allegations sufficient to state claims under Sections 11 and 12(2), regardless of any purported applicability of Rule 9(b), and notwithstanding the absence of allegations of the Appellant class's reliance on the Offering Materials.

Billet v. Storage Technology Corp., 72 F.R.D. 583 (S.D.N.Y. 1976)

Griffin v. McNiff, 744 F.Supp. 1237, 1253-54 (S.D.N.Y. 1990), *affirmed* 996 F.2d 303 (2d Cir. 1993)

Herman & MacLean v. Huddleston, 459 U.S. 375, 103 S.Ct. 683, 74 L.Ed.2d 548 (1983)

Pinter v. Dahl, 486 U.S. 622, 638, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988)

Securities Act of 1933, Section 11, 15 U.S.C. 77k

Securities Act of 1933, Section 12(2), 15 U.S.C. 77*l*(2)

2. Whether the District Court abused its discretion in denying Appellants leave to amend their complaint under Federal Rules of Civil Procedure 15(a) and 16(b), in that Appellants had obtained none of their requested discovery from Appellees prior to the time Appellees' motions to dismiss the complaint were submitted; Appellants' motion to amend came four months before the close of discovery, after they had discovered sufficient information to cure any purported pleading defects in all three counts of the complaint as soon as the District Court ruled on them; and Appellees would suffer no prejudice from the proposed amendment, which added no new theories or parties.

(a) Whether good cause existed to modify the District Court's scheduling order and permit amendment of Appellants' complaint to make it more specific, but not to add new parties or claims, after the ruling of April 11, 1996 which found the complaint insufficient, for the first time, well in advance of the trial date and the close of discovery.

(b) Whether Appellants' proposed Consolidated Second Amended Class Action Complaint states claims upon which relief may be granted and cures the supposed defects in specificity which the District Court found under Rule 9(b).

(c) Whether the "Bespeaks Caution Rule" and the "Safe Harbor Rule" constitute an absolute bar to any and all claims Appellants could possibly allege under Sections 11 and 12(2), and thereby justifies the District Court's denial of leave to amend, regardless of any misrepresentations or omissions of historical fact in the Offering Materials which are the subject of the case.

Buder v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 644 F.2d 690 (8th Cir. 1981)

Foman v. Davis, 371 U.S. 178, 83 S.Ct. 227, 9 L.Ed.2d 222 (1962)

Frey v. City of Herculaneum, 44 F.3d 667 (8th Cir. 1995)

Sanders v. Clemco Industries, 823 F.2d 214 (8th Cir. 1987)

3. Whether the District Court erred in applying the "Safe Harbor" and "Bespeaks Caution" doctrines and F.R.C.P. 9(b) to dismiss Count III of Appellants' Consolidated Amended Class Action Complaint for failure to state a claim upon which relief can be granted under Section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5.

Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972)

Conley v. Gibson, 355 U.S. 41, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957)

Harris v. Union Electric Company, 787 F.2d 355, 366 (8th Cir. 1982)

Shores v. Sklar, 647 F.2d 462 (5th Cir. 1981)

Securities Exchange Act of 1934, Section 10(b), 15 U.S.C. 78j(b)

APPENDIX H

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

IN RE NATIONSMART CORPORATION
SECURITIES LITIGATION

Civil Action No 4:94-CV-2182 (JCH)

THIS DOCUMENT PERTAINS TO ALL ACTIONS

CONSOLIDATED AMENDED
CLASS ACTION COMPLAINT

JURY TRIAL DEMANDED

Plaintiffs, individually and on behalf of persons similarly situated, by their undersigned attorneys, for their complaint (the "Complaint"), allege upon personal knowledge as to themselves and their own acts, and upon information and belief based upon, *inter alia*, the investigation made by and through their attorneys, as follows:

NATURE OF THE ACTION

1. This class action for violations of the federal securities laws arises out of the defendants' misrepresentations, concealments and failure to correct material misstatements made in connection with an initial public offering in which 2 million units of the securities of defendant NationsMart Corporation ("NationsMart" or "the Company") were offered and sold to the investing public at a price of $7.00 per unit (the "Offering") on December 22, 1993. Each unit consisted of one share of common stock and a warrant to purchase one additional share of common stock.

2. By the time the long-delayed NationsMart Offering closed on December 22, 1993, defendants knew that cost and revenue

trends had moved consistently and materially in the wrong directions. Rather than cancel the Offering, the defendants concealed the adverse developments, which severely compromised the viability of NationsMart's purported business plan. In addition, the defendants falsely stated that dealings with affiliates were at arms-length and that NationsMart was in compliance with federal wage and hour laws, and falsely omitted to state that the president of NationsMart was lending company money to his personal business associates for improper purposes. After the Offering, defendants made a series of misleading disclosures, which were designed to and did conceal NationsMart's problems from the market. NationsMart is now in serious financial difficulty, and the market value of its stock has dropped 82%.

3. NationsMart belatedly acknowledged that the Company had insufficient capital and as a result would be unable to fulfill the expansion strategy that was central to the business plan which had been described in the Offering Materials and other publicly issued statements. In addition, defendants revealed that they lacked the financial resources to open additional sites in accordance with the projected opening schedules of Wal-Mart and K-Mart "supercenters" as set forth in the Offering Materials, subsequent Securities and Exchange Commission ("SEC") filings and in defendants' public statements throughout the Class Period (defined herein in ¶ 12).

JURISDICTION AND VENUE

4. (a) This action arises under Sections 11 and 15 of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §§ 77k, 77l(2), and 77o; Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 ("Exchange Act") 15 U.S.C. §§ 78j(b), 78t(a), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5.

(b) This Court has jurisdiction over the action under Section 22 of the Securities Act, 15 U.S.C. § 77v, Section 27 of the Exchange Act, 15 U.S.C. § 78a, and 28 U.S.C. § 1331 by virtue of claims that arise under the laws of the United States.

5. Venue is proper in this District pursuant to Section 22 of the Securities Act, Section 27 of the Exchange Act and 28 U.S.C. § 1391. The offer and sale of securities which is the subject of this action occurred in this District and Division. Many of the acts alleged herein, including the preparation and dissemination to the investing public of a false and misleading prospectus and registration statement, occurred in substantial part in this District and Division.

6. In connection with the conduct complained of herein, the defendants, directly or indirectly, offered, sold and solicited sales of NationsMart securities using means and instrumentalities of interstate commerce and the United States mails, and the facilities of the national securities markets, namely, the NASDAQ.

THE PARTIES

7. (a) Plaintiff Jack Carlson purchased 1,000 NationsMart units during the Class Period at $7.00 per unit.

(b) Plaintiff Helen S. Palmquist purchased 1,000 NationsMart units during the Class Period at $7.25 per unit.

(c) Plaintiff Brian Palmquist purchased 500 NationsMart units during the Class Period at $7.25 per unit.

(d) Plaintiff John D. Palmquist purchased 500 NationsMart units during the Class Period at $7.25 per unit.

(e) The securities purchased by each plaintiff are traceable to the Offering.

8. Defendant NationsMart, a Missouri corporation, began operations in June 1992. Its principal place of business is located

in this District and Division at 11644 Lilburn Park Road, St. Louis, Missouri 63146.

(a) At all times relevant, NationsMart was engaged in the operation of small retail dry cleaning, laundry and shoe repair shops located on the premises of Wal-Mart, K-Mart and other large national retail stores. NationsMart operates facilities under the names of "s'MART Centers" in Wal-Mart super centers and "SK Centers" in Super K-Mart Centers.

(b) On December 22, 1993, pursuant to a Registration Statement and Prospectus (the "Offering Materials") filed with the Securities and Exchange Commission ("SEC"), defendants commenced an initial public Offering of two million units at a price of $7.00 per unit. Each unit consisted of one share of common stock and one warrant to purchase an additional share of common stock, at a price of $7.00 per share.

9. The following defendants (the "Individual Defendants") were, throughout much or all of the relevant time period, directors or officers of NationsMart, or both. Each of the Individual Defendants below signed the Registration Statement pursuant to which NationsMart securities were offered:

(a) Defendant Michael E. Thaman ("Thaman") was, at the time of the Offering and until June 17, 1994, President, Chief Executive Officer and a director of the Company. At the time of the Offering, Thaman owned or controlled 193,194 shares of NationsMart common stock. This represented approximately 4.7% of NationsMart's outstanding common stock before the Offering and 3.2% following the Offering.

(b) Defendant Alice E. Brueggemann ("Brueggemann") was, at the time of the Offering and until her termination on March 8, 1994, Senior Vice President, Treasurer and Chief Financial Officer of NationsMart.

(c) Defendant S. Leslie Flegel ("Flegel"), co-founder of NationsMart, was, at all relevant times, a director of the Company and Chairman of the Company's Executive Committee. Defendant Flegel was also the principal owner and Chief Executive Officer of Display Information Systems Corporation ("Display"). During the Class Period set forth hereinafter, Display derived substantial income from NationsMart by renting office space and providing clerical services to the Company. At the time of the Offering, Flegel owned or controlled 658,551 shares of NationsMart common stock. This represented approximately 16.4% of NationsMart's outstanding common stock before the Offering and 10.9% following the Offering. On March 15, 1994, defendant Flegel sold 37,626 shares of NationsMart common stock while in possession of adverse material non-public information regarding the Company's shortage of funds and probable inability to continue the Company's publicly projected plans for expansion.

(d) Defendant Mel A. Friedman ("Friedman"), co-founder of NationsMart, was, at all relevant times, a director of the Company and its Executive Vice President. At the time of the Offering, defendant Friedman owned or controlled 685,572 shares of NationsMart common stock. This represented approximately 17.1% of NationsMart's outstanding common stock before the Offering and 11.4% following the Offering. On March 15, 1994, defendant Friedman sold 37,626 shares of NationsMart common stock while in possession of adverse material non-public information regarding the Company's shortage of funds and probable inability to continue the Company's publicly projected plans for expansion.

(e) Defendant Alan G. Johnson ("Johnson") was, at all relevant times, a director and Secretary of the Company.. Defendant Johnson was also, at all relevant times, a senior partner in the St. Louis, Missouri law firm of Gallop, Johnson & Neuman. Defendant Johnson was at all relevant times the Secretary of

defendant Pauli & Company, Inc. Gallop, Johnson & Neuman derived substantial income from legal services allegedly provided to NationsMart throughout the Class Period. At the time of the Offering, Johnson owned or controlled 567,954 shares of NationsMart common stock. This represented approximately 14.2% of NationsMart's outstanding common stock before the Offering and 9.5% following the Offering.

(f) Defendant Franklin A. Jacobs ("Jacobs") was, at all relevant times, a director of the Company and a member of its Executive Committee. Defendant Jacobs is also President, Chairman of the Board and Chief Executive Officer and a principal shareholder of Falcon Products, Inc. ("Falcon"). Throughout the Class Period, Falcon derived substantial income from the sale of store fixtures to the Company. At the time of the Offering, Jacobs owned or controlled 441,854 shares of NationsMart common stock. This represented approximately 11.0% of NationsMart's outstanding common stock before the Offering and 7.4% following the Offering.

(g) Defendant S. Lee Kling ("Kling") was, at all relevant times, a director and a member of the Executive Committee of the Company and was Chairman of its Board of Directors until June 1993. At the time of the Offering, Kling owned or controlled 386,168 shares of NationsMart common stock. This represented approximately 9.6% of NationsMart's outstanding common stock before the Offering and 6.4% following the Offering.

(h) Defendant Michael J. Dunlap ("Dunlap") was at all relevant times, NationsMart's Controller and Principal Accounting Officer.

10. Defendant RAS Securities Corp. ("RAS"), a New York corporation, is an underwriting and investment banking firm which conducts business in this District. RAS was one of two lead underwriters of the Offering (the "Underwriter Defen-

dants") and received substantial fees as an underwriter of the Offering.

11. Defendant Pauli & Company, Inc. ("Pauli"), a Missouri corporation, is an underwriting and investment banking firm which conducts business in this District. Pauli was one of the two lead underwriters of the Offering and received substantial fees as an underwriter of the Offering.

CLASS ALLEGATIONS

Plaintiff Class

12. This action is brought by plaintiffs as a class action pursuant to Rule 23(a) and (b)(3) of the Federal Rules of Civil Procedure. Plaintiffs seek relief for themselves and all other persons who purchased or otherwise acquired NationsMart securities in the Offering or in the open market during the period from December 22, 1993 through August 18, 1994 (the "Class Period"), and who suffered damages as a result thereof (the "Class"). Excluded from the Class are the defendants herein, members of the immediate family of each of the Individual Defendants, and affiliates, successors and assigns of the individual and corporate defendants.

13. The members of the Class are so numerous that joinder of all members is impracticable. Two million units of NationsMart securities were sold in the Offering and thousands of shares of stock were traded during the Class Period.

14. Plaintiffs' claims are typical of the claims of the members of the Class. They purchased NationsMart securities that were registered with the SEC pursuant to the Offering Materials, and thereby sustained injury as a result of the unlawful acts of defendants alleged herein.

15. Plaintiffs will fairly and adequately protect the interests of the members of the Class. Plaintiffs have retained competent

counsel experienced in class litigation under the federal securities law, and do not have interests antagonistic to or in conflict with those they seek to represent.

16. Common questions of law and fact exist as to all members of the Class and predominate over any questions affecting solely individual members of the Class. Among the questions of law and fact common to the Class are:

(a) Whether defendants engaged in acts or conduct in violation of the federal securities laws;

(b) Whether defendants participated in and pursued the common course of conduct complained of herein;

(c) Whether the Offering Materials and other public statements of NationsMart disseminated to the investing public by defendants and to the members of the Class omitted or misrepresented material facts about the earnings and operating condition of NationsMart;

(d) Whether the price of NationsMart's securities was inflated due to defendants' misrepresentations and omissions; and

(e) Whether the members of the Class are entitled to rescission and/or damages and, if monetary damages have been sustained, what the proper measure is of those damages.

17. A class action is superior to other available methods for the fair and efficient adjudication of this controversy. Because the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation makes it impossible for the Class members individually to seek redress for the wrongful conduct alleged. There will be no difficulty in managing this action as a class action.

SUBSTANTIVE ALLEGATIONS

18. NationsMart was founded in 1992 to provide dry cleaning, laundry and shoe repair services in leased vestibule locations within stores operated by national retailers such as K-Mart and Wal-Mart.

19. The original version of the Prospectus was filed with the SEC early in October, 1993, reflecting a proposed offering price of the units in the amount of $8.00 per unit.

20. The Offering Materials portrayed NationsMart as a rapidly growing company which was about to reap the enormous profits which follow when a heretofore unknown retail concept is perfected and exploited with a major capital infusion.

21. NationsMart's stated goal was to open new stores in "supercenter" stores then operated or to be opened by Wal-Mart and K-Mart, which supposedly represented a "rapidly expanding retail concept."

22. In the Offering Materials and in its other public statements and filings, the Company repeatedly touted its planned expansion to 600 locations by 1998. In addition, the Prospectus specifically stated that a portion of the proceeds of the Offering were to be used to fund the opening of 108 new stores. Regarding the specific uses of the net proceeds from the sale of the 2,000,000 units, estimated to be $11.7 million, the Prospectus stated:

> The Company anticipates that such net proceeds will be used to fund (i) approximately $4.1 million in capital expenditures associated with the opening of 108 additional Centers anticipated to be opened before November 1994, primarily in Wal-Mart Supercenters and Super K-Mart Centers, (ii) approximately $4.0 million in expenses associated with the operation of the approximately 159 Centers anticipated to be open by such date and (iii) approximately

> $3.6 million payable to redeem its 10% redeemable subordinated notes (the "Notes"), approximately $450,000 principal balance of which is payable to directors, officers and employees of the Company.

The Offering Materials also represented that:

> The Company believes that the net proceeds of this Offering will be sufficient to accomplish the purposes for which such net proceeds are expected to be used. Implementation of the Company's business plan for establishing and operating additional centers after such date will require additional external funding.

The representations set forth above were false and materially misleading due to the facts described herein, which facts defendants knew or should have known deprived the statements of any reasonable basis when the statements were made.

23. Regarding NationsMart's sales and growth prospects, the Prospectus continued:

> *Management expects significant and rapid growth in net sales during 1994 and in future years to occur as a result of:* (1) *full period net sales provided by existing Centers opened in earlier periods*; (2) greater market penetration within the communities served by existing Centers, based on convenience of location and hours, quality of service and everyday low pricing and the volume of traffic generated by host retailers' stores, and (3) the planned opening of additional Centers in accordance with the projected opening schedules of Wal-Mart and K-Mart.

[Emphasis added.]

24. The Offering Materials also represented that:

> The Company has to date scheduled openings for 14 Centers in the first quarter of 1994, 32 Centers in the second

quarter of 1994, 36 Centers in the third quarter and 26 Centers in the fourth quarter of 1994.

The Company expects to fund the expenses of opening and initially operating these new Centers, as well as operating the 51 existing Centers, though the net proceeds of the Offering and to a lesser extent, funds expected to be provided by the operating activities of established Centers.

25. On page 20, the Prospectus stated that the "company believes that substantial opportunities exist to expand in the market for dry-cleaning, laundry and shoe repair services" which the Company intended to capitalize on, "primarily by opening additional Centers in Wal-Mart Supercenters and Super K-K-Mart Centers and to develop similar relationships with other prominent national retailers". The leading risk of the announced strategy, according to the Prospectus, supposedly was the inability of the Company to assure that such retailers would commit to allow new NationsMart stores to open in all such retail stores. This was qualified, however, by the statement on page 21 of the Prospectus that "based upon the 113 additional Centers assigned to the company to date, the company expects to open Centers in approximately 600 new supercenters to be opened on various dates from 1994 through 1998." The "600 Centers" figure was repeated and featured prominently throughout the Prospectus.

26. The Offering Materials were designed to and did convey that the representations regarding expected growth were based upon a meaningful "financial model" in which defendants had a justifiable, good faith belief. The Offering Materials represented:

Based upon its financial model, management believes that previously experienced operating losses will diminish as currently operating Centers, most of which have been open fewer than six months, begin to generate income from

> operating activities. Additionally, the net proceeds of this offering will significantly improve the capital resources of the Company and thereby address certain of the going concern conditions. Management further believes that as operating losses diminish and the number of operating Centers increases, additional external sources of capital will become more readily available to the Company. *Accordingly, management considers the conditions which resulted in questions about the Company's ability to continue as a going concern to be transitory.* However, the financial model used by the Company reflects only the best judgment of management and actual results are substantially dependent on numerous factors, many of which are outside the Company's control: accordingly, there can be no assurance that the results indicated by its financial model will be achieved.

[Emphasis added.]

27. The Prospectus contained a "Risk Factors" section disclosing in a general and summary fashion some categories of risk inherent in the type of aggressive expansion that was supposedly planned by NationsMart. However, the Prospectus was extremely upbeat about NationsMart's prospects, touting the "proved" and "tested" nature of the NationsMart formula, and conveying the impression that the major risk faced by NationsMart was that so many K-Mart and Wal-Mart "host" locations would open that they would outrun NationsMart's ability to keep pace.

28. While the "Risk Factors" section of the Prospectus disclosed that there could be no assurance that the Company's Centers could generate income or positive cash flow, it contained no hint of any risk that the Offering proceeds would be insufficient to allow NationsMart to successfully implement its business plan.

29. At page 11, the Prospectus stated that NationsMart had "developed and fine-tuned its methods of operation, including

the institution of a formal employee training program, the development and implementation of merchandising techniques, the improvement and standardization of opening procedures, and the installation of sophisticated electronic point-of-sale and management information systems . . . The Company currently has plans to open an average of approximately 125 new Centers annually from 1994 through 1998." Statements such as those conveyed to potential investors the message that NationsMart had perfected a viable concept which required a specified capital infusion to implement, which funding was to be provided by the Offering.

30. Defendants knew that the representations in the Offering Materials that the Company could fulfill its business plan through October 1994 were false and misleading and not reasonably based. Defendants knew that the sales forecasts upon which the statements were based were not justifiable or reasonable based on historical data. At the time of the Offering and shortly thereafter, defendants were in possession of, or had access to, projections prepared by the Underwriter Defendants. The underwriters' projections conclusively demonstrated that NationsMart would be unable to fulfill its business plan even with the proceeds of the Offering. The underwriters' projections further demonstrated that cash flow from NationsMart's existing locations and those to be opened in the first quarter of 1994 would be insufficient to allow for continued expansion of locations in Wal-Mart and K-Mart stores.

31. When the Underwriter Defendants submitted those projections to officers of the Company responsible for planning the Offering, Company officers rejected them and gave the Underwriter Defendants baseless new projections for inclusion in the Offering Materials. The projections given to the Underwriter Defendants for inclusion in the Offering Materials were false and made without a reasonable basis. The defendants knew that the projections they intended to release to the investing public,

including the Class, were false and had no reasonable basis because they knew that there were no valid assumptions underlying the projections. The projections prepared by Company officers were materially more optimistic than those prepared by the underwriters and were the basis for the material misrepresentations set forth in the Offering Materials.

32. Gross profit for NationsMart was reported at page 16 of the Prospectus as being 38.4% of net sales for the first nine months of 1993. This, however, was alleged to be an unrepresentatively low figure because of promotional specials used during each new Center's "start up phase (usually the first 90 days after opening)" and the large "number of new Centers opened in 1993".

33. The Prospectus stated (*e.g.*, at page 18) that direct Center opening costs were $42,000 each, whereas in fact new store openings cost well in excess of that amount.

34. Expenses of opening new Centers (direct) were reported at pages 16 and 17 of the Prospectus to be $197,260, or 13.1% of net sales for the first three quarters of 1993, the decrease from the 1992 level of 90.9% of net sales being attributable to "increased efficiencies associated with additional Centers and the high total sales level achieved during the thirty-nine weeks ended September 26, 1993". The Prospectus also stated that the initial staffing level needed to open a store would, without further increased expense, support a much larger level of sales, leading to the conclusion that most or all new sales would directly enhance each store's profit after the 90 day start-up phase.

35. In a similar vein, the Prospectus stated at page 17 that both individual store general and administrative expenses and corporate general and administrative expenses would decline as a percentage of net sales as overall and same-store sales rose.

36. The Prospectus stated at page 18 that the Company expected to fund the "expenses of opening and initially operat-

ing" 108 new Centers, plus the expense of operating the 51 existing stores with the proceeds of the Offering.

37. The Offering Materials were designed to and did create the false impression that defendants, in making the foregoing representations, had considered all relevant financial risks and that defendants' projections were reasonable and made in good faith based upon fair consideration of all relevant negative factors.

38. The Prospectus, at page 19, stated that the Company's auditors had issued a report on the Company's latest year's financial statements with a "going concern" qualification. The Prospectus, however, attempted to minimize any concerns arising from the qualification, stating that management had a "financial model" showing that "losses will diminish as currently operating Centers . . . begin to generate income" and that the Offering would address "certain of the going concern conditions." Thus, the Company represented in the Prospectus that "management considers the conditions which resulted in questions about the company's ability to continue as a going concern to be transitory."

39. On December, 22, 1993 (the "Effective Date"), the Company's Offering Materials covering the Offering were declared effective at a price of $7.00 per unit and NationsMart units began trading on the NASDAQ. Also on December 22, 1993, regarding the Offering, defendant Thaman stated, "We are pleased to achieve this important milestone in NationsMart's development. Building on our strong organization and network of established centers, *our new capital resources will enable us to continue our market expansion.*" [Emphasis added.]

40. Integral to NationsMart's success and attractiveness as an investment and either explicit or implicit in the Offering Materials were the Company's supposedly fair dealings with affiliates, compliance with law and management's stated confidence in predictions and stated expectations about NationsMart's fu-

ture performance which were supposedly based on actual historical financial data and trends.

41. In reality, however, during the months immediately before the Effective Date, defendants knew of and learned a variety of adverse facts concerning NationsMart's performance, including that there were no favorable revenue, profit and expense trends as described in the Prospectus; that projected trends were not materializing and were not likely to materialize; that NationsMart had no site selection strategy, other than to open a Center willy-nilly wherever and whenever a new Wal-Mart Supercenter or Super Kmart opened, regardless of local competition or demographic suitability; and that the Company was routinely breaking the law and entering into "sweetheart" deals with affiliates of NationsMart's officers and directors.

42. In the months immediately prior to the Offering, many, if not most, significant indicators of NationsMart's performance and future success were on a steep downward slope, including but not limited to the following:

(a) the amount of time which defendants believed a store had to operate before becoming profitable had continually increased significantly, i.e., the expected "break-even" date for a store had been extended and was becoming even more distant;

(b) the amount of money needed to open and subsidize a Center until it became profitable had increased substantially and was continuing to increase;

(c) the cost to operate existing Centers had increased substantially;

(d) corporate overhead was ballooning, and despite the Prospectus' statements to the effect that as of the end of September, 1993, the Company had substantially completed the "infrastructure" needed to carry the Company forward without substantial additional expenditures in this regard, NationsMart

spent almost as much in the last three months of 1993 as it had in all of the preceding nine months;

(e) while the Prospectus states that the defendants expected corporate overhead as a percentage of net sales to decline, they knew by the Effective Date that the percentage of corporate overhead to net sales had not declined appreciably. Indeed, except for a brief section of the first quarter of 1994, corporate overhead as a percentage of net sales had *increased*, from 76% (as disclosed in the Prospectus) to 83% (as disclosed in the Company's 10-Q for the second quarter of 1994, page 2); and

(f) the Company's "burn rate", or the rate at which it used up its capital, had skyrocketed. The Prospectus disclosed that the Company would be out of money in January, 1994, absent the Offering. It did not disclose the exponential increase in expenses and costs which had put it in that position. Nor did it disclose the lack of any realistic prospect that the situation would improve after the Offering.

43. On or about February 3, 1994, NationsMart reported that for January, 1994, same store sales for the Company's first nine of 51 centers increased an average of 47.2% to $84,000 as compared to $57,000 in January 1993. It was also reported that for fiscal year 1993, the Company's first nine centers achieved an average same store sales increase of 105.5% to $330,000 as compared to $161,000 for the comparable period for each center in fiscal 1992. Purportedly, the Company's total sales for its 51 operating centers in January 1994 amounted to $458,000 compared to $57,000 in January, 1993.

44. On or about March 4, 1994, NationsMart announced expansion plans which overshadowed the report of a [illegible] loss for the quarter. The Company reported that it had been offered outlets in 68 Wal-Mart stores and 55 K-Mart stores for potential operation in 1994. The Company also reported a net loss of $4.8 million for fiscal 1993 on sales of $2.9 million, compared with

a loss of $504,420 on sales of $147,944 the previous year. NationsMart operated 51 centers in 1993 compared to only nine centers in fiscal 1992. Because the loss was in line with analysts' expectations, coupled with the Company's announcement of major expansion plans, the price of the Company's common stock increased nearly 18% from $3 1/2 on March 2, 1994 to $4 1/8 on March 7, 1994.

45. In an interview on or about March 31, 1994, defendant Thaman stated, "We are probably going to open eighty to eighty-five stores this year. With that growth alone, coupled with [approximately fifty-nine] existing stores, our sales should grow five to six times." That statement, indicating the Company intended to operate as many as 144 stores in 1994, was materially misleading when made, having no reasonable basis in fact.

46. On March 31, 1994, Robert Derrington of defendant Pauli touted NationsMart's competitive superiority. An analyst from defendant RAS stated that NationsMart should show a profit within 15 months

47. On or about April 1, 1994, NationsMart filed with the SEC its Annual Report on Form 10-K for the fiscal year ended January 2, 1994 (the "10-K"). In the 10-K, the Company continued to tout its ability to open additional stores in accordance with the projected opening schedules of Wal-Mart and K-Mart "supercenters." Specifically, NationsMart stated that it had been offered 71 additional locations by Wal-Mart, and 49 by K-Mart, in which to open new stores. Of those 120 additional locations, NationsMart stated its intention to open 114 stores in fiscal year 1994: 3 in the remainder of the first quarter; 29 in the second quarter; 47 in the third quarter; and 35 in the fourth quarter.

48. The 1993 Form 10-K noted, however, surprisingly, that NationsMart planned to close 20% of its Centers for underperformance. On April 3, 1994, instead of simply "stickering" the Prospectus, a post-effective amendment to the

S-1 Registration Statement, containing revised financial data, was filed. That post-effective amendment withdrew from registration the securities sold in December, 1993, but did *not* refund the purchase price.

49. On or about May 9, 1994, NationsMart reported its results for the first fiscal quarter of 1994, ended April 3, 1994. The Company reported net sales of $1,425,000 for the quarter compared with net sales of $272,000 for the first quarter of 1993. The Company reported a net loss of $1,737,000, or 29 cents per share for the first quarter of 1994 compared with a loss of $427,000 or 10 cents per share in the first quarter of 1993. Commenting on first quarter 1994 results, defendant Thaman stated, "The losses are within our expectations given the speed of our growth." Continuing to mislead the investing public as to NationsMart's ability to open additional stores in accordance with the projected opening schedules of Wal-Mart and K-Mart "supercenters," defendant Thaman added, "as of the end of the first quarter, Wal-Mart and K-Mart have offered us an additional one hundred seven (107) locations for potential openings in the remainder of 1994. Based on our Center selection criteria, we expect to open approximately seventy-five (75) of the one hundred seven (107) locations."

50. On May 16, 1994, NationsMart issued its Quarterly Report on Form 10-Q ("10-Q") for the quarter ended April 3, 1994. In the 10-Q, defendants reported the financial results previously announced for the quarter and also reported that:

> Based upon its financial model, management believes that certain of the currently operating Centers, a substantial portion of which have been open fewer than nine months, will begin to generate income from operating activities within the next year. Management further believes that as individual Centers reach profitability and the number of operating Centers increases, additional external sources of

> capital will become more readily available to the Company. *Accordingly, management expects that the conditions which resulted in concerns about the Company's ability to continue as a going concern will be alleviated in the future* (See Note 2 - Operating Losses and Capital Resources). However, the financial model used by the Company reflects only the best judgment of management and actual results are substantially dependent on numerous factors, many of which are outside the Company's control, accordingly, there can be no assurance that the results indicated by its financial model will be achieved. [Emphasis added.]

This statement was false and misleading because defendants knew that their financial model was based on assumptions that were unreasonable in light of historical data. Defendants were advised on more than one occasion in January and February of 1994 by Company officers that the sales forecasts were unreasonable and not supported by the Company's financial model. In addition, defendants knew that based upon their then current estimates of cash use, the proceeds of the Offering would not be sufficient to allow NationsMart to fund its operations and expansion through the third quarter of 1994. The false and misleading 10-Q was signed by defendants Thaman and Dunlap.

51. Contrary to numerous positive statements in the Company's Offering Materials and other subsequent public filings, on or about June 24, 1994, the investing public began to understand that NationsMart was hemorrhaging money and that the Company would be forced to implement a reorganization program.

52. In addition to reductions in staffing at the St. Louis office, the Company announced the resignation of defendant Thaman as President and a director of NationsMart. One week prior to the announcement, defendant Thaman had been replaced by Charles D. Goorman ("Goorman") as Chief Executive Officer. Goorman thereafter served as President, Chief Executive Officer and

Chairman of the Board of Directors through the end of the Class Period until his death in a car accident. As a means to raise much-needed capital for the Company, Goorman announced that the Company was examining the possibility of selling NationsMart franchises.

53. Further evidence of the Company's true financial condition and its prior misrepresentations to the investing public emerged on or about June 27, 1994, when defendant Brueggemann filed suit against the Company and its directors related to her secretive dismissal in March of 1994. In that lawsuit, which was quickly settled, with the settlement subject to stringent non-disclosure agreements, Brueggemann alleged that she was fired for telling defendants Thaman, Kling, Johnson and Jacobs in January of 1994, days after the Registration Statement became effective, that i) purported sales forecasts set forth in the Prospectus were baseless and falsely optimistic, and she had insisted that the S-1 registration be revised to reflect known negative facts and adverse developments; ii) Thaman had been "burying" loans to friends in false financial statements; iii) NationsMart books and records had been altered; iv) NationsMart was wilfully violating the Fair Labor Standards Act ("FLSA"), a crime under 29 U.S.C. §216(a); and v) certain affiliated party dealings were unfair to NationsMart. All of those facts were contrary to implicit or explicit representations in the Offering Materials. *See Brueggemann v. NationsMart Corporation, et al.*, Cause No. 664688 (St. Louis County, Missouri, Circuit Court).

54. Defendant Brueggemann also stated in her suit that, on January 24, 1994, she formally relayed her complaints in a meeting with defendant Kling. Thus, defendants had actual notice, on or before January 24, 1994, from the Company's Chief Financial Officer, that statements contained in the Offering Materials, namely, that the proceeds of the Offering would fund, *inter alia*, the opening of 108 new stores and the operation of the existing 51 stores by November 1994, were false, materially

misleading and had no reasonable basis in fact. On February 14, 1994, defendant Flegel informed Brueggemann that the Company was considering firing her. On March 8, 1994, NationsMart's Board of Directors carried out its threat and fired defendant Brueggemann. She was replaced by Richard A. Happel ("Happel"). On June 6, 1994, the Company announced that Happel had joined the Company as Senior Vice President of Finance, effective June 1, 1994. The Company, however, declined to comment as to Brueggemann's employment status at the time of the June 6, 1994 announcement.

55. On or about July 9, 1994, defendant Flegel stated, "There are people who think the IPO was done too soon. But the bottom line is that we needed to raise capital and there was a good opportunity." Offering a possible reason for the Company's shortage of capital, Goorman added, "You can't just open stores like crazy and forget about running the stores you've got." Defending the move to generate capital by selling franchises, defendant Flegel stated, "We made this move for positive reasons, not negative reasons. We think we have things well under control."

56. On or about July 14, 1994, the Company admitted its inability to open additional stores in accordance with the projected opening schedules of Wal-Mart and K-Mart "supercenters." In fact, the Company was experiencing such a dramatic shortage of capital that the Company admitted that by year-end 1994 it would open 35 to 45 fewer Centers than were represented in the Offering Materials. The Company also disclosed that it was experiencing slower than anticipated growth in its stores. Finally, the Company also disclosed that it had settled the lawsuit with Brueggemann, although the terms of the settlement were not disclosed.

57. Following the Company's startling announcement, NationsMart common stock closed at $1.875, down from a high of $6.50 per common share less than six months earlier. The

following day, Friday, July 15, 1994, the Company's stock continued to decline, closing at $1.625 for the week.

58. On August 17, 1994, NationsMart filed its Form 10-Q report for the second quarter of 1994. That report showed that only $2.6 million of the $11,382,000 raised only six months before remained to be spent, and reported net sales for the quarter of $1,741,441. The loss reported from operations was $2,823,783, for a net loss of $2,787,745, or $.46 per share.

59. The "source of the losses" was reported to be "expenses associated with opening new retail dry cleaning . . . units . . . in . . . K-Mart stores . . ."

60. In an article on August 18, 1994, the *St. Louis Post-Dispatch* reported that "NationsMart Corp., burning up millions more in precious cash raised in its public stock offering nine months ago, reported a $2.8 million loss on sales of $1.7 million in the quarter ended July 3." The article continued: "with its troubles mounting, NationsMart is undertaking an 11th-hour attempt to drop its costs and change direction by selling franchises."

61. Other announcements from NationsMart in the ensuing months have made it clear that the situation continues to get worse. Significantly, however, NationsMart has still never disclosed, and has falsely denied, many of the facts alleged herein.

62. Nevertheless, defendants have been forced to make further admissions regarding the previously concealed adverse material facts as the situation has become even more dire. In the Company's Quarterly Report on Form 10-Q for the quarterly period ended October 2, 1994 the Company admitted:

> The Company has continued to incur losses from operations, as well as negative cash flow from operating activities through October 2, 1994. The source of these losses is

the expenses associated with opening new retail dry cleaning, laundry and show repair units ("Centers") in host Wal-Mart and K-Mart stores (See Note 5), the cost of operating Centers until their revenues result in operating profits, and the overhead to support the corporate services and infrastructure necessary to operate the Company and support the operations of the Centers. During the thirty-nine week period ended October 2, 1994, the Company opened 44 additional Centers and closed seven, resulting in 88 Centers in operation, compared to 51 at the beginning of the period.

While these losses are not inconsistent with management's initial expectations, the negative cash flow associated with the losses has put a burden on the Company's ability to open planned Centers for the balance of 1994. Accordingly, the Company has agreed with Wal-Mart to accept only ten of the locations offered to it for opening before the end of 1994.

63. As bad news continued to be revealed, the price of NationsMart units slid from an issue price of $7.00 to only $1.25 as of October 19, 1994. The continuing price decline is attributable to the partial disclosure over time of the adverse information that had been concealed from and misrepresented to the investing public.

64. During the Class Period, the Company failed to disclose to the market that the sales and growth forecasts contained in the Company's Offering Materials were overly optimistic and had no reasonable basis in fact. Instead, the defendants allowed the market to continue to trade based upon the defendants' prior statements, statements which the defendants knew, or were reckless in not knowing, were no longer, if ever, true or accurate.

65. Throughout the Class Period, defendants had a duty to correct and update their statements as soon as they knew or should have known that the statements were materially false and

misleading. Nevertheless, the defendants made no effort to inform the market that statements of material fact they had previously made were no longer, if ever, true or accurate. Instead, the defendants allowed the market to continue to believe and allowed shareholders and members of the public to purchase shares of the Company based upon statements previously made which the defendants knew, or were reckless in not knowing, were no longer, if ever, true or accurate.

COUNT I

Against All Defendants for Violation of Section 11 and Against the Individual Defendants for Violation of Section 15 of the Securities Act

66. Plaintiffs repeat and reallege paragraphs 1 through 65 as if fully set forth herein.

67. Pursuant to Section 11 of the Securities Act, the Class is entitled to recover its damages jointly and severally from defendants, as follows:

(a) Defendant NationsMart as the issuer;

(b) The Individual Defendants as signatories of the Registration Statement and/or Directors or Officers of NationsMart; and

(c) The Underwriter Defendants as underwriters for the Offering.

68. The Offering Materials contained untrue statements of material facts and omitted facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

69. All defendants were responsible for the materially false and misleading contents of the Offering Materials.

70. Plaintiffs and members of the Class purchased NationsMart securities issued pursuant to the Offering Materials and without knowledge of the defendants' materially false statements and omissions.

71. Neither the plaintiffs nor any member of the Class seeks to recover for purchases of NationsMart's securities after NationsMart had made generally available to security holders an earnings statement covering a period of at least twelve months beginning after the Effective Date.

72. This action was commenced within one year from when plaintiffs and other Class members purchased NationsMart shares pursuant to the Prospectus, and within the time provided in the appropriate statute of limitations.

73. As a direct and proximate result of defendants' wrongful conduct, plaintiffs and the Class have suffered substantial damages in connection with their purchases of NationsMart common stock.

74. Plaintiffs do not allege in this Section 11 claim that defendants, or any of them, were guilty of scienter, that is, of any scheme to defraud or of any misrepresentations or omissions that were made intentionally or recklessly.

COUNT II

Against NationsMart and the Underwriter Defendants for Violation of Section 12(2) of the Securities Act

75. Plaintiffs repeat and reallege paragraphs 1 through 65 as if fully set forth herein.

76. NationsMart and the Underwriter Defendants offered, sold, and solicited sales of shares, by means of the Prospectus which included untrue statements and omissions of material fact. NationsMart and the Underwriter Defendants were sellers of the

shares of NationsMart stock within the meaning of Section 12(2) of the Securities Act.

77. Plaintiffs and the members of the Class did not know of any of the omissions or that the statements were false.

78. The losses suffered by plaintiffs and members of the Class were proximately caused by the acts of NationsMart and the Underwriter Defendants in selling or soliciting the sale of securities of the Company in violation of Section 12(2) of the Securities Act.

79. By virtue of the foregoing, all members of the Class who purchased shares in the Offering or on the basis of the Prospectus are entitled to recover damages from NationsMart and the Underwriter Defendants, jointly and severally. Plaintiffs, individually, and on behalf of other members of the Class still holding common stock purchased in the Offering or on the basis of the Prospectus, hereby tender to NationsMart and the Underwriter Defendants the common stock each purchased, and demand return of the consideration each paid, together with interest, less the amount of any income received.

80. Plaintiffs do not allege in this Section 12(2) claim that defendants, or any of them, were guilty of scienter, that is, of any scheme to defraud or of any misrepresentations or omissions that were made intentionally or recklessly.

COUNT III

Against All Defendants under Sections 10(b) and 20 of the Exchange Act and Rule 10b-5

81. Plaintiffs repeat and reallege paragraphs 1 through 65 as if fully set forth herein.

82. At the time of the Offering, defendants knew, *inter alia*, that the sales and growth forecasts contained in the Offering Materials had no reasonable basis in fact.

83. The defendants were at all relevant times under a duty to correct prior statements by disclosing the Company's true prospects for growth and sales. The defendants failed to do so and allowed plaintiffs, investors and the market in general to continue to rely upon the false and misleading Offering Materials to the foreseeable detriment and damage of plaintiffs and the Class.

84. The Company's statements misled investors, concealing the vital fact that NationsMart's business had been permanently and materially impaired and its ability to survive is imperiled.

85. During the Class Period, the Individual Defendants knowingly or recklessly participated in a common course of conduct, which included acts and practices that operated as a fraud and deceit upon plaintiffs and other members of the Class, by making various untrue statements of material fact, or by making statements that omitted to state material facts in order to make the statements made, in light of the circumstances under which they were made, not misleading to plaintiffs and other members of the Class. Pursuant to that common course of conduct, the defendants named in this Complaint caused NationsMart to make false and misleading statements of material fact, and to omit material facts or to correct false material facts, to its shareholders and the investing public. These material misstatements and omissions are particularized herein.

86. The Offering Materials and other public statements made by the defendants contained untrue statements of material facts and omitted facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

87. The defendants had knowledge of those material misstatements and omissions, and knew that the statements were untrue or acted with reckless indifference to the truth or falsity of those statements.

88. Plaintiffs and other members of the Class, at the time of the alleged misrepresentations and omissions, were ignorant of the falsity of the statements, and believed them to be true. In reliance upon the defendants' misrepresentations, the integrity of the market and the securities offering process, and upon the fidelity, integrity and superior knowledge of the defendants, and in ignorance of the truth, plaintiffs and the other Class members were induced to and did obtain NationsMart securities. Had plaintiffs and the other members of the Class known the truth, they would not have taken such action.

89. As a result of the dissemination of the materially false and misleading statements alleged herein, and the defendants' failure to disclose material facts, the price of NationsMart securities were artificially inflated in the Offering and throughout the Class Period.

90. As of April 3, 1994, NationsMart had several million unrestricted shares of common stock outstanding. NationsMart common stock was traded during the Class Period through the NASDAQ Small-Cap Market — an active and efficient market — by means of a nationwide electronic trading network that instantly and simultaneously reflects, on thousands of trading screens, computerized market information concerning stock price and trading activity and displays relevant current data concerning the Company that is supplied by newswire services, thereby insuring a liquid market for NationsMart securities.

91. Each of the defendants engaged in a conspiracy to accomplish all or part of the unlawful conduct alleged.

92. The defendants employed devices, schemes and artifices to defraud and engaged in acts, practices and a course of conduct in an effort to maintain an artificially high market price for the common stock of NationsMart, which included the making of untrue statements of material fact and omitting to state material facts necessary in order to make the statements made about

NationsMart and its financial and operating conditions, in light of the circumstances under which they were made, not misleading, and engaged in transactions, practices and courses of business which operated as a fraud and deceit upon the purchasers of NationsMart's common stock, and upon the market for NationsMart common stock, during the Class Period. Defendants would not have been able to sell NationsMart's shares in the market if not for their scheme to defraud. During the Class Period, the Individual Defendants issued public statements, releases and reports, including the Offering Materials and other documents, which were materially false and misleading in that they failed to disclose material adverse information about the earnings, business, financial condition and future business prospects of NationsMart.

93. The defendants, by virtue of their offices, directorships, stockholdings and/or specific acts were, at the time of the wrongs alleged herein, controlling persons of NationsMart within the meaning of Section 20 of the Exchange Act. Collectively, the Individual Defendants had the power and exercised same, through their actions as directors or officers, to cause the company to sell its stock to the public. Each such defendant had the power and influence and exercised the same to cause NationsMart to engage in the illegal conduct and practices complained of herein. Each of the Individual Defendants had and exercised the power to sign the materially false and misleading Registration Statement containing the Prospectus pursuant to which the Offering was marketed. Without signatures of the Individual Defendants on the Form S-1 Registration Statement the Offering could not have been accomplished.

94. By reason of the conduct alleged herein, the defendants violated Sections 10(b) and 20 of the Exchange Act and SEC Rule 10b-5.

95. Plaintiffs and the Class members have been damaged as a direct and proximate consequence of the unlawful conduct of the defendants.

WHEREFORE, plaintiffs on behalf of themselves and the Class pray for judgment as follows:

A. Declaring this action to be a proper class action maintainable pursuant to Rule 23 of the Federal Rules of Civil Procedure;

B. Declaring plaintiffs to be proper representatives of the Class;

C. Awarding to plaintiffs and the Class compensatory damages, together with appropriate prejudgment interest at the maximum rate allowable by law with respect to Counts I and III; and awarding plaintiffs and members of the Class rescission as to Count II to the extent that they still hold their shares of common stock or, if said stock has been sold, awarding damages in accordance with Section 12(2) of the Securities Act;

D. Awarding to plaintiffs and the Class their costs and expenses for this litigation, including reasonable attorneys' and experts' fees, and other disbursements; and

E. Awarding to plaintiffs and the Class such other and further relief as may be just and proper under the circumstances.

JURY DEMAND

Plaintiffs demand a trial by jury.

Dated: May 1, 1995